

STANDARD & POOR'S	RATINGS DIRECT

Research:

[Return to Regular Format](#)

Hawaii; Tax Secured, General Obligation

Publication date: 21-Apr-2004

Credit Analyst: Gabriel Petek, San Francisco (1) 415-371-5042; Alexander M Fraser, Dallas (1) 214-871-1406

Credit Profile

US\$225. mil GO and rfdg bnds ser 2004DD&DE due

05/01/2024

AA-

Sale date: 28-APR-2004

AFFIRMED

\$3.359,948 bil. Hawaii

AA-

\$300.000 mil. Hawaii GO bnds of 1998 ser CR dtd 04/01/1998 due 04/01/2003-2018

AAA/AA-(SPUR)

\$201.540 mil. Hawaii GO bnds of 1999 ser CT dtd 09/15/1999 due 09/01/2003-2019

AAA/AA-(SPUR)

\$250.000 mil. Hawaii GO bnds of 2002 ser CX dtd 02/15/2002 due 02/01/2007-2022

AAA/AA-(SPUR)

\$225.000 mil. Hawaii GO bnds of 2003 ser DA dtd 09/16/2003 due 09/01/2008-2023

AAA/AA-(SPUR)

\$336.620 mil. Hawaii GO rfdg bnds of 1998 ser CS dtd 04/01/1998 due 04/01/2003-2009

AAA/AA-(SPUR)

\$188.650 mil. Hawaii GO rfdg bnds of 2003 ser DB dtd 09/16/2003 due 09/01/2008-2016

AAA/AA-(SPUR)

\$150.000 mil. Hawaii Ser CU Dtd 10/15/2000 Due 10/01/2020

AAA/AA-(SPUR)

\$456.750 mil. Hawaii go bnds ser 2001 dtd 08/01/2001 due 08/01/2005-2021

AAA/AA-(SPUR)

\$319.290 mil. Hawaii go rfdg bnds of 2002 ser CY dtd 02/15/2002 due 02/01/2007-2015

AAA/AA-(SPUR)

OUTLOOK:

STABLE

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' rating to Hawaii's \$225 million GO and refunding bonds, series 2004 DD and DE, and affirmed the 'AA-' rating on the state's outstanding GO debt. The rating reflects Hawaii's:

- Tourism-based economy with above-average wealth and income indicators;
- Continued adequate financial position supported by the recent affirmation of revenue growth projections; and
- High, but still manageable, debt burden.

The bonds are secured by the full faith and credit pledge of the state.

Hawaii's economy continues in an expansionary phase, with positive job growth trends supported by strong domestic visitor arrivals, which continue to provide lift to the state's important tourism sector. In addition to continued recovery in tourism, Hawaii's economy is benefiting from strong construction activity and a stable military presence with increased spending in both industries. Although cumulative visitor arrivals were down by 0.8% through 2003, they are in a recovery phase, on track to increase by 5.2% to 6.74 million in 2004. Hotel occupancy rates in 2003 increased to 72.5%, the highest occupancy level since 2000, when they reached 76%. Thus far into 2004, occupancy rates remain robust and were at 85% for February. The decrease and then recovery in arrivals over the past 2.5 years has not had an

adverse impact on Hawaii's total employment figures, thanks to some offset from strong trends in construction, government and finance, insurance, and real estate. At 591,000 total jobs in 2003, the increase in Hawaii's civilian employment was one of the largest in the nation at 6.2%. For the year, unemployment was 4.3%, also a very favorable level compared to other states in the nation. Moreover, the state has not experienced a dramatic increase in applications for welfare. Personal incomes continue to grow and were up 4.8% in the fourth quarter of 2003, keeping pace with the annual increase of 5.0% achieved in 2002. Personal income is forecast to continue its growth pattern, with projections calling for a 3% or higher increase in 2004 through 2006.

State revenues are forecast to grow by 5.2% in fiscal 2004, a figure recently affirmed by the state's Council on Revenues. Although the projected growth rate remained unchanged from the previous forecast in December 2003, the updated projection incorporated the countervailing effects of higher consumer inflation (due to strong personal income growth) offset by the state's recent cement workers' strike (which slowed construction activity). On a budgetary basis, fiscal 2003 ended with a \$16.8 million deficit, equivalent to a small 0.44% of expenditures. This compares favorably to 2002, when the state ended with a deficit of \$215 million, equivalent to 5.9% of expenditures. Hawaii's ending budget reserve in fiscal 2003 is estimated at \$117 million, or 3.1% of expenditures, from \$134 million, or 3.7% of expenditures, in fiscal 2002. For fiscal 2004, the state is budgeting for a \$95 million ending balance (plus \$50.5 million in its emergency budget reserve). The state's budget reserves do not include balances held in its emergency budget reserve fund. The emergency budget reserve fund was established in 1999 and currently receives 24.5% of the state's tobacco settlement money. As of June 30, 2003 the fund had a balance of \$53.1 million. The fund is projected to have a balance of \$54.3 million at the end of fiscal 2004 and \$78.7 million at the end of fiscal 2005. Although at 1.4% of expenditures the emergency budget reserve is small relative to total state expenditures, the establishment and maintenance of the fund represent an important step toward institutionalizing prudent financial management policies for the state. Suggestive of this financial conservatism is that appropriations from this fund require a two-thirds majority vote of both houses of the legislature. In fact, the legislature did appropriate \$10.5 million of the fund for fiscal 2004 for various purposes. Signaling a commitment to fiscal discipline, the governor has indicated that she intends to refrain from implementing the expenditures despite the legislature's appropriation. Similarly, soon after taking office, the governor publicly committed to maintaining the state's \$184 million hurricane relief fund, which had been identified in early fiscal 2003 as a potential one-time source available to balance the 2004 budget that was being developed at the time.

Hawaii's debt burden is high, with about \$3.4 billion of state GO debt translating to a high per capita level, \$2,772, and 10% of personal income. The burden is manageable, however, since the state issues all debt for Hawaii schools, which, for most states, is issued at the local level.

■ Outlook

The stable outlook reflects Standard & Poor's Ratings Services' expectations that Hawaii will continue to take steps to control expenditures through the period of slow revenue growth, which will allow the state to maintain sufficient, although lower, financial reserves. The outlook also reflects the expectation of expenditure controls despite increased future cost-of-living adjustments for state employees. Hawaii's continued improving economy helps to provide credit stability.

■ Economy

Hawaii's economy remains significantly reliant on tourism, an industry that currently has mixed but improving conditions. Global security concerns and a weak dollar abroad have enhanced the state's appeal for domestic tourists, while indications of a long-awaited recovery in Japan are finally appearing, though visitors from Japan declined by 3.9% in 2003 as a whole. This recent improvement, combined with a robust construction sector, contribute to the good performance of Hawaii's economy, with positive job growth trends, in contrast to other states, that accelerated over four straight quarters from 2002 into 2003 and ended with an all-time high number of jobs for the state for 2003. While job growth had been projected to be 1.9% in 2003, actual job growth was somewhat stronger at 2.1%, although it is projected to moderate somewhat in 2004 to 1.5%. Job growth has been in construction- and military-related employment, with most recent growth beginning to occur in the leisure and hospitality sectors.

Wealth and income indicators revealed some softness, with 2001 data indicating median household effective buying income (EBI) and per capita EBI in 2002 at 100.9% and 89.5%, respectively. Both figures were down in 2001 from 2000, most likely from the incorporation of census data, but were down further in 2002.

■ Finances

As Hawaii's economy improved in the later 1990s, the state was able to restore and somewhat institutionalize its financial health. On an audited basis, the state ended fiscal 2003 with an unreserved fund balance of \$290 million, equivalent to 8.3% of expenditures. Fiscal 2003 operating revenues, which grew 4.4%, were mostly from the state's general excise and use taxes (56% of revenues) followed by the individual income tax (33%). The budget for fiscal 2004 calls for 53.6% of operating expenditures to be allocated to education (including K-12 and higher education). Human services and health-related expenditures total 22.8% of spending. For fiscal 2005, the governor proposed a supplemental budget to increase general fund spending by 2.3%, or \$86.3 million in 2005. Doing so will increase overall spending to \$4 billion and leave the state with a projected ending general fund balance of \$94.4 million, or 2.3% of expenditures. However, the state will still contribute to its emergency budget reserve, estimated to have a balance of \$62.8 million at the close of fiscal 2005. Interest earnings of the emergency budget reserve are credited to the general fund.

As noted, in 1999, the state created an emergency budget and reserve special fund to be funded with a portion of proceeds from money received from the tobacco companies. While the dollar amount is not significant relative to the state's budget, this rainy day fund provides some additional financial cushion. Prior to the Sept. 11, 2001 terrorist attacks, Hawaii was allocating 40% of its tobacco settlement money, with interest income accruing, to the general fund. Legislation from a special session in the fall of 2001 reduced that percentage to 24.5%. As of June 30, 2003, the balance in the emergency and budget reserve was \$53.1 million, compared to \$49.8 million the prior year. The state projects this balance to grow to \$81.3 million by the end of fiscal 2007, compared to previous projections of \$110.0 million by the end of fiscal 2005 under the previous funding schedule.

■ Debt

Hawaii's debt ratios remain very high, with direct state debt--including these 2004 series of bonds--at about \$2,741 per capita. This is, in part, attributable to the state's assumption of many functions that are generally financed by local governments in other states, including local education, health, and welfare. Debt levels, however, rose rapidly during the 1990s, as the state shifted from pay-as-you-go capital spending to GO bonds. Hawaii's state debt is among the highest of all the U.S. states, and debt servicing consumed 10.9% of general resources in fiscal 2001. Debt amortization is aggressive, however, with 73% of principal repaid in the next 10 years. Because the state's debt is front loaded--with the bulk of principal scheduled for amortization in 2006-2009--the current issuance does not begin repaying principal until 2008, the latest allowed under the state constitution. This structure allows the state's debt service to become somewhat more level.

Much of the new money proceeds from the current financing is for new infrastructure projects targeted for the K-12 education system and for the University of Hawaii. Following the current financing, the state has just over \$1.0 billion of authorized but unissued GO debt capacity remaining. The governor has announced an intention to scale back the state's debt contribution to its capital plan. Although \$400 million was authorized for issuance in 2005, the current plan calls for a smaller GO issue of approximately \$148 million.